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SUBJECT: MACEDONIA: GOM FACING POTENTIAL POLITICAL FALLOUT  
FROM ELECTRICITY SHORTAGES

#### Summary

1. (SBU) Macedonia's new government faces several critical challenges in the electricity market. In the short-term, the supply of available electricity may not be sufficient to meet demand this winter. In addition, the newly privatized electricity distribution company is beginning to enforce payment by customers -- including individuals, businesses and government offices -- who have become accustomed to not paying for electricity. Both developments could create political fallout for the GOM. In the longer term, Macedonia will need to boost investment in its electricity infrastructure to enable the privatized distribution company to provide a reliable power supply at a reasonable cost to consumers. End summary.

#### Electricity Supply And Demand

2. (U) The state-owned Macedonian power generation company ELEM produces 75 to 80 percent of the electricity consumed in the country. The majority of that electricity is produced by five aging lignite coal power plants. Eight hydroelectric plants also produce electricity. The state-owned electricity transmission company, MEPSO, imports the balance of the electricity needed. Demand is highest in the winter, since a large share of households and businesses heat their buildings with electricity.

3. (U) The state also owns a back-up fuel oil power plant near the town of Negotino that is costly to operate and is used only when other sources are insufficient to meet demand. The Negotino plant can produce up to 210 megawatts daily, a significant amount, but not enough to cover the gap between other domestic production and demand. In past years, this mix of imported electricity and domestic generation, with the extra supply from the Negotino plant, has provided sufficient electricity for Macedonia in past years.

#### Enough Electricity This Winter?

4. (SBU) This winter, however, Macedonia may not have enough electricity to meet demand, especially after January 1, 2007. Due to its limited financial resources, MEPSO had secured only relatively short-term contracts to import electricity

through the early part of 2007. MEPSO opened a tender in September to purchase additional contracts of imported electricity for January to April 2007, but so far has been able to secure only about a third of the electricity it sought. Local energy experts predict the regional supply of available electricity will be low this winter due to increased demand in nearby countries, and that regional power supplies will be reduced by the impending closure of a Bulgarian nuclear power plant.

15. (SBU) The GOM recently sent a supplementary budget request to parliament for 20 million euros to cover fuel oil for the Negotino back-up plant. In part to save power, and in part due to a dispute over long overdue electricity bills, MEPSO also cut the electricity to one of Macedonia's largest electricity customers, Silmak, which processes metal alloys. Silmak owes MEPSO several million dollars in unpaid bills. Following the power cuts, Silmak furloughed a number of its employees, who have threatened to strike if they are not re-instated. Further complicating the political picture for the government, Silmak is owned by the head of the Macedonian Socialist Party, a governing coalition junior partner.

16. (SBU) Putting an optimistic face on this grim power supply picture, the newly appointed Chairman of ELEM, Vlatko Cingoski, assured us recently that there would be a sufficient supply of electricity to meet household demand this winter. He said the Negotino plant could supply enough electricity to make up any household demand shortfall. If that is not adequate to meet demand, he said the GOM has concluded agreements with the country's largest industrial consumers to reduce their supply of electricity during the winter.

17. (SBU) Despite his optimistic outlook, Cingoski admitted to us that ELEM had not been conducting scheduled maintenance on its coal-fired plants this year due to financial problems. In order to continue the winter electricity supply uninterrupted, maintenance will have to be deferred until next spring, since the plants must be shut down during that process. In addition, Cingoski said, ELEM has not stored enough reserve coal for the winter and the company is now building up its reserves. Despite these potential pitfalls, Cingoski was optimistic that Macedonia's coal plants would continue to operate at near full capacity during the coming months, ensuring a steady supply for ELEM's operations.

#### Unpaid Bills

18. (SBU) When the electricity distribution company ESM (which transmits electricity to the customers from the large capacity transmission network managed by MEPSO, and collects payments) was state-owned, there was no political will to enforce payment collection for past due bills. As a result, many customers became accustomed to not paying for electricity. Before ESM was privatized, the company unsuccessfully filed approximately 500,000 court cases for non-payment, but it did not disconnect electricity to customers who failed to comply. The GOM privatized ESM in March 2006, selling it to the Austrian company EVN for 225 million euros. EVN claims that, when it took over, the collection rate for electricity was at a low 55 percent.

19. (SBU) After EVN purchased the distribution system, the new owners immediately began making ESM employees pay their personal electricity bills. In August, EVN began disconnecting electricity to government offices and large companies that were behind on their payments. According to EVN Macedonia CEO Gunther Ofner, the collection rate for households and businesses has begun to increase, although there are still some towns and neighborhoods where almost no customers pay for electricity. He said the GOM and municipal governments still owe approximately 25 million euros for electricity bills.

110. (SBU) Ofner said EVN recognizes the political sensitivity of disconnecting electricity to households and businesses, especially if those actions are perceived as

unfairly targeting one or another ethnic group. Nevertheless, EVN has to enforce payment in order to make the distribution company financially viable, Ofner said. He noted that EVN had begun talks with the GOM on how to increase the collection rate while ensuring that the poorest households receive a minimal amount of electricity.

#### "Lost" Electricity

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¶11. (SBU) In addition to a low collection rate, there is a high rate of electricity loss due to technical problems and theft. The President of the Energy Regulatory Commission, Slave Ivanovski, told us that when the Commission sets the price of electricity, they calculate an 11 percent electricity loss rate due to technical reasons. The actual loss rate is 24 percent. This figure includes electricity lost due to illegal connections to the electricity network, as well as customers who "adjust" their meters so that they appear to consume less electricity.

#### Unsustainable Cheap Electricity

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¶12. (U) The other key to the sector's financial woes is that the price of domestically generated electricity has remained low. While imported electricity costs about 0.08 cents/kWh, the regulated price that MEPSO pays ELEM for electricity is now regulated at about 0.03 cents/kWh. Although low electricity rates for consumers are politically appealing, the result is continued underinvestment in the energy sector. Despite the unsustainably low prices, Ivanovski told us that ELEM so far has not requested that the Energy Regulatory Commission increase the price of electricity supplied by ELEM.

#### Privatization of Electricity Generation?

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¶13. (SBU) The previous government's privatization plan for the sector, developed with the assistance of USAID and other international donors, called for the privatization of all state-owned generation assets. The previous GOM began a tender for the sale of the Negotino power plant before the July election and agreed with the IMF that it would privatize ELEM in 2007.

¶14. (SBU) The new government, however, appears reluctant to proceed with the full privatization of ELEM. The GOM's four-year work program envisions "the gradual privatization of parts of the energy sector while preserving the dominance of state ownership." Cingoski, a political appointee and an influential adviser to the new government on energy issues, told us the GOM is considering merging ELEM and MEPSO under one holding company, and then privatizing ELEM's assets piecemeal over an extended period. However, the GOM would retain at least a 25 percent stake in the privatized assets. Cingoski argued that, if ELEM were able to charge more for the electricity it produces, the GOM could finance new power plants without privatizing ELEM.

¶15. (U) On November 1, the GOM canceled the tender for the privatization of the Negotino power plant. The GOM had received bids from four international companies in May 2006, but did not award the tender before the July elections. The previous government ranked EVN's bid first because it had proposed to invest the largest amount, 750 million euros, in upgrading the existing power plant and building new power plants on the existing site. The current government claims EVN's bid included many unacceptable conditional requirements, and that its proposed purchase price of four million euros for the power plant was too low. The GOM plans to announce a new tender for the Negotino plant by the end of November.

#### Comment: Swift Action Needed

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¶16. (SBU) If electricity supplies are inadequate to meet household demands this winter, the GOM could face strong political pressure from the public to intervene to ensure MEPSO and ESM do not cut household power supplies. If that

happens, and supplies to major industrial consumers are cut instead, the GOM will face pressures from furloughed workers and disgruntled industrialists to boost power imports to cover the shortfalls. That, in turn, could result in pressure from the IMF, which the GOM likely would resist, not to exceed fiscal expenditure targets.

¶17. (SBU) To offset such challenges, the GOM will immediately have to pay its own electricity arrears. It also should also work with EVN to ensure that the poorest households can afford a minimum level of electricity supply. For electricity generation, ELEM will need to propose to the regulatory commission an increase in the price of domestically generated electricity in order to adequately cover operations and maintenance costs. In addition, the GOM should privatize ELEM to honor Macedonia's IMF commitment, and should open up the market for additional private investment in new generation capacity. Unfortunately, the GOM at present does not appear prepared to move forward quickly on these steps.

MILOVANOVIC